PERAC PENSION NEWS

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LETTER FROM THE EXECUTIVE DIRECTOR

The recent passing of three stalwart members of the retirement community, Tom Curtis, Joe DeSisto, and Sheila Tobin, saddened all of us at PERAC. I would like to offer the sincere condolences of the Commission and staff to their families and friends at this time of sorrow.

Thomas Curtis passed away in August 2005. Tom was Chairman of the Medford Retirement Board for many years, a former Deputy Chief of the Medford Fire Department, and a MACRS Executive Board Member of long-standing. He was a tireless worker for retirees and employees.

October 2005 brought the loss of both Joseph A. DeSisto and Sheila Tobin.

Joe served as former Veteran's Agent in Stoneham and was a long-time member of that town's Retirement Board. He was the friend, not only of the Veterans to whom he was so dedicated during his time at Town Hall, but also of all of Stoneham's retirees whose welfare was his concern. ***(Continued on page 2)***

PERAC REPORT FINDS FALSE VALUATIONS AND SPECULATION LED TO PENSION FUND LOSS

by Joseph I. Martin
Deputy Executive Director of Policy & Development

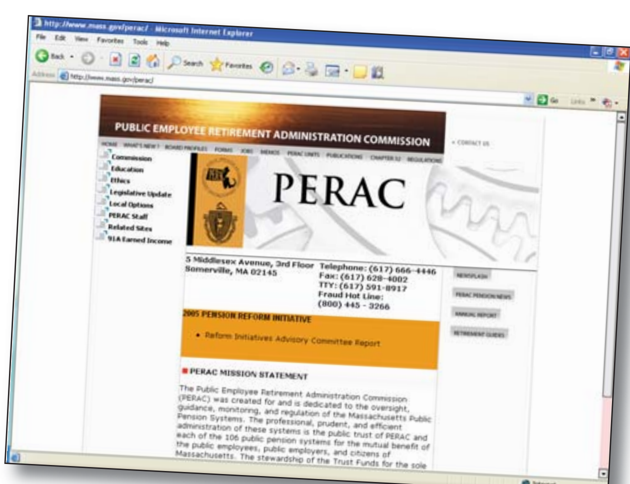
The Public Employee Retirement Administration Commission (PERAC) has released a report on the loss of $38 million by the Middlesex Retirement Board in an investment with now defunct Cambridge Financial Management. The Report concludes that James Kneafsey, the deceased principal of Cambridge Financial, sustained serious losses in speculative currency trading that deviated significantly from his mandate. Kneafsey then provided false valuations of the holdings in the Middlesex portfolio, hiding the extent of the losses. ***(Continued on page 2)***

PERAC LAUNCHES NEW WEB SITE

by Sarah Kelly
Communication & Education Director

To help fulfill PERAC's ongoing commitment to clear communication with retirement boards and others in the public pension community, the agency recently launched a streamlined redesign of the Web site: www.mass.gov/perac.

Come visit us online.



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LETTER FROM THE EXECUTIVE DIRECTOR (CONT.)

(From page 1) Sheila Tobin was a colleague of mine since she was first elected to the Cambridge Board of Retirement in 1983. She was steadfast in her representation of the members and beneficiaries right up to the time of her death.

It was a privilege to work with Tom, Joe, and Sheila. We will miss them dearly.

I would like to honor the memory of all public pension board members and administrators who pass away by recognizing their loss in this publication. Of course, we don't want to overlook anyone. Retirement boards that wish us to note the passing of a colleague should contact me.

Sincerely,

Joseph E. Connarton

Joseph E. Connarton
Executive Director

PENSION FUND LOSS (CONT.)

(From page 1) "Although others may have failed to detect or act on signs that Cambridge Financial was engaged in risky and inappropriate trading, the central cause of these losses is the deception perpetrated by that firm," PERAC Executive Director Joseph Connarton said.

PERAC also criticized the Middlesex Retirement Board and its consultant Wainwright Investment Counsel for failing to adequately monitor the Cambridge Financial activity and for failing to ensure that independent valuation of the Cambridge Financial holdings was in place.

"We will never know whether a more aggressive monitoring of Cambridge's activities would have led to Middlesex realizing the true status of the account value, but we do know that the monitoring that did take place did not uncover what was really happening," Connarton noted.

The Report also found that common industry practice related to the setting of limits on the trading available to Cambridge Financial and the lack of disclosure of those limits to investors contributed to a lack of knowledge on the part of Middlesex.

Goldman Sachs, which traded with Cambridge Financial, and Mellon Bank, which served as custodian to Middlesex and also traded with Cambridge Financial through its Foreign Exchange desk, were found to have enabled Kneafsey to trade at levels that were inappropriate to his mandate by regularly increasing limits on his trading.

These increases supported the frenetic trading activity that Cambridge Financial engaged in from late 2001 until the spring of 2003. Neither Mellon Foreign Exchange nor Goldman Sachs notified Middlesex of these limit increases.

"The increases in these limits," Connarton observed, "enabled Kneafsey to engage in trading at levels and in denominations that resulted in the losses to Middlesex. The fact that these actions took place without informing Middlesex is disturbing and, as this is the common industry practice, we hope to work with industry leaders to ensure that disclosure does take place in the future."

PERAC has been reviewing this matter since being informed of the losses by Middlesex in 2003. The Commission ordered Middlesex to conduct a fiduciary audit, which has been recently released. That audit found that some of the monitoring practices of the Board were not up to standards and recommended a variety of changes in practices and procedures. Middlesex is in the process of implementing those recommendations.

Middlesex is engaged in litigation with Mellon relative to the issue of the pricing of the Cambridge holdings. In preparing reports for Middlesex, Mellon used valuations provided by Kneafsey. These valuations overstated the value of the Cambridge account by a significant margin.

The Report is not the final word from PERAC on this matter as several relevant issues continue to be reviewed.

PUBLIC HEARINGS ON THE DEFINITION OF REGULAR COMPENSATION

The Commission has begun the process for promulgating an amendment to clarify its regulation regarding the definition of regular compensation [840 CMR 15.03]. The amendment will clarify the status of temporary salary increase, often called salary augmentation or enhanced longevity plans. Such plans, usually contained in collectively bargained agreements, provide a multi-year salary increase that does not become a permanent part of the employee's compensation.

Public comments will accepted through December 13, 2005. **In order to provide maximum participation by all individuals who may be impacted by the proposed regulations, the Commission has voted to expand the time of each hearing listed below to 6:00 PM at each of the designated locations.**

- **11/30/05, 1:00 PM:** Plymouth Public Library, 132 South Street, Plymouth, MA
- **12/2/05, 1:00 PM:** The Clarion Hotel & Conference Center, One Atwood Drive, Northampton, MA
- **12/6/05, 2:00 PM:** McCormack Building, Conference Room 3, 21st Floor, One Ashburton Place, Boston, MA
- **12/8/05, 10:00 AM:** PERAC Training Room, 5 Middlesex Avenue, 3rd Floor, Somerville, MA

INVESTMENT UPDATE

by Robert A. Dennis, C.F.A.
Investment Director

Unless US equities produce far greater returns than currently expected over the next few years, public pension systems that invest only in US stocks and bonds will continue to face challenging times in terms of meeting their investment objectives.

For systems that have enjoyed the most impressive returns in recent years, domestic stocks and bonds have been almost insignificant asset classes. Enhanced returns have come not only from international investments (both developed and emerging markets) but also from other asset classes such as real estate, alternative investments (venture capital and private equity), and high-yield bonds. Although recent returns from hedge funds have been lackluster, many institutional investors have also begun to establish positions in "absolute return" strategies (as distinguished from "relative returns" from meeting or beating a specific market benchmark) that are expected to produce positive returns regardless of actual market performance.

In our periodic market commentaries and other investment education presentations, PERAC has frequently stressed the importance of diversification among and within both traditional and alternative asset classes. For systems that are not currently invested in any asset classes other than US stocks and bonds and those systems that may seek to increase their allocations to diversifying asset classes, the PRIM Board's segmented investment options in international equity, real estate, alternative investments, and absolute return have all performed well and are worthy of consideration. PERAC regulatory approval is not required for any investment with PRIM.

In today's quest for elusive "alpha" (i.e, returns in excess of a particular market benchmark), institutional investors have begun to consider new products such as "real return" and "global asset allocation" funds that may use derivatives and/or some short-selling in pursuit of their strategies. These aspects may be at odds with PERAC investment regulations, but if a retirement board and its investment consultant are satisfied with the risk controls inherent in such products, boards may use the supplementary regulation process to request PERAC approval.

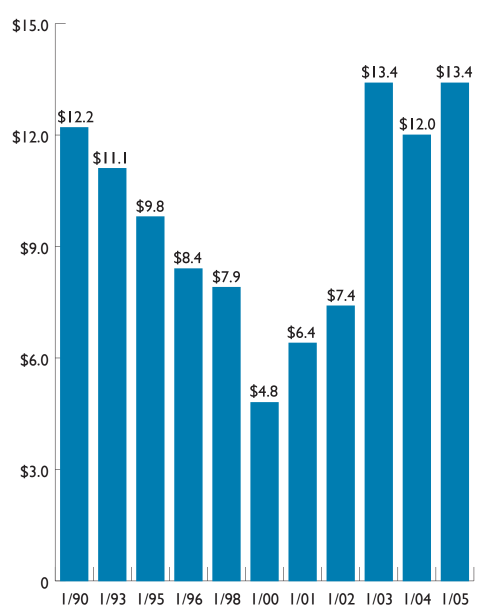
PERAC RECENTLY COMPLETED THE COMMONWEALTH VALUATION STUDY REPORT AS OF JANUARY 1, 2005

by James Lamenzo
Actuary

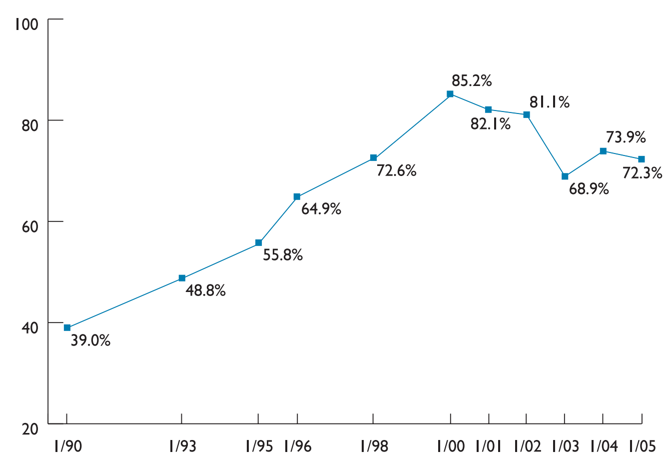
We have shown two charts from the report. The first chart shows the Commonwealth's unfunded actuarial accrued liability (UAL) since 1990. The UAL represents the actuarial accrued liability less the actuarial value of plan assets. When there is no UAL, a system is said to be "fully funded."

The second chart shows the Commonwealth's funded ratio progress since 1990. The funded ratio represents the actuarial value of plan assets divided by the actuarial accrued liability. When the funded ratio reaches 100%, a system is "fully funded".

COMMONWEALTH UNFUNDED LIABILITY
(in billions of dollars)



COMMONWEALTH FUNDED RATIO



PERAC ISSUES COLA REPORT: STUDY ANALYZED COST IMPACTS OF INCREASING THE COLA BASE

by James Lamenzo
Actuary

In September, PERAC released its analysis of Section 375 of Chapter 149 of the Acts of 2004 which required PERAC to evaluate the costs and actuarial liabilities associated with increasing the base to which cost of living adjustments (COLAs) are applied under G.L. c. 32, §102.

The legislation provided that the costs and liabilities be analyzed for COLA bases ranging from $12,000 to $22,000 in increments of $1,000. The legislation also provided that funding schedules be developed that reduce the increase in unfunded liability due to the increased COLA bases to zero by June 30, 2028, June 30, 2034, and June 30, 2038.

The results in the report reflect the January 1, 2004 valuation results for the State Retirement System, State Teachers' Retirement System, and Boston teachers. These groups determine the Commonwealth funding schedule.
The costs for the current $12,000 COLA base, as well as for the $16,000 and $20,000 bases are presented below. The costs reflect the Commonwealth's current funding schedule (4.5% annual increasing, amortization to FY23).

The Commissioners voted at the September 22, 2005 meeting to recommend the COLA base be increased to $16,000. The Commission's recommendation is that a modification of the current schedule, if necessary, be adopted to fund the increased COLA cost.

The complete report, *PERAC Report on Impact of COLA Base Increase,* can be found on PERAC's Web site: www.mass.gov/perac under Actuarial Unit/Reports/Other Reports.

COLA Base	$12,000	$16,000	$20,000
		(Amounts are in thousands)	
1. Total Normal Cost	1,026,624	1,046,386	1,063,412
2. Expected Employee Contributions	778,285	778,285	778,285
3. Net Normal Cost	248,339	268,101	285,127
Actuarial Accrued Liability			
4. Active	24,478,858	24,903,582	25,313,224
5. Retiree	20,325,364	20,802,408	21,217,622
6. Inactive	732,987	743,000	753,000
7. Local COLA	522,000	522,000	522,000
8. Total Actuarial Liability	46,059,209	46,970,990	47,805,846
9. Increase in Actuarial Liability		911,781	1,746,637
10. % Increase in Actuarial Liability		2.0%	3.8%
11. Actuarial Value of Assets	34,045,177	34,045,177	34,045,177
12. Unfunded Liability (UAL) (8) – (11)	12,014,032	12,925,813	13,760,669
Funding Schedule Development			
13. Normal Cost (FY05): (3) x 1.0825	268,827	290,219	308,650
14. Amortization of UAL 4.5% increasing to 2023	922,785	992,817	1,056,942
15. FY05 Total	1,191,612	1,283,037	1,365,592
16. FY05 Increase		91,425	173,980

HAPPY HOLIDAYS FROM EVERYONE AT PERAC

This will be the last issue of *PERAC Pension News* for 2005. On behalf of the Commission and staff—best wishes to everyone for a happy holiday season and a prosperous new year.